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Director Brand and Trade Channel Integrity
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April 11, 2016

Massachusetts Department of Revenue
100 Cambridge St.
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Boston, MA 02114

**Re: Response to OTP Market Overview and Tax Enforcement Solutions Presentation to
Massachusetts Illegal Tobacco Task Force by SICPA/Meyercord on March 8, 2016**

Altria Client Services LLC (ALCS), on behalf of Philip Morris USA Inc. (PM USA), U.S. Smokeless Tobacco Company LLC (USSTC) and John Middleton Co. (JMC),¹ submits these comments to the Massachusetts Illicit Tobacco Task Force (Task Force) as it considers additional opportunities to address illicit tobacco trafficking including whether tax stamping for Other Tobacco Products (OTP) is worth considering as tool for Massachusetts' anti-trafficking efforts.

On March 8, 2015, SICPA/Meyercord (SICPA) made a presentation to the Task Force advocating for the Commonwealth to purchase additional tobacco excise tax stamps, in this case, stamps for Moist Smokeless Tobacco (MST). While we understand SICPA's significant business interest in selling Massachusetts stamps for another tobacco category, SICPA's proposal may have created a misunderstanding by some on the Task Force regarding the efficacy, cost and effectiveness of OTP stamping.

While tax stamps can play an important role in addressing certain forms of illicit tobacco products, presentations like SICPA's often over-simplify the illicit trade issue or assume an actual benefit from the technology that is proposed. SICPA suggests that Massachusetts' MST excise tax revenue collection could quadruple with the adoption of tax stamps.² This is directly contrary to Massachusetts' own experience with SICPA's tax stamps on cigarettes.³ SICPA also claims that the adoption of MST stamping could be done through an "affordable, flexible and

¹ PM USA, USSTC and JMC are wholly owned subsidiaries of Altria Group, Inc. (Altria). ALCS provides certain services, including Brand and Trade Channel Integrity, to the Altria group of companies. "We" and "our" are used throughout to refer to PM USA, USSTC and JMC

² "OTP Market Overview and Tax Enforcement Solutions", SICPA/Meyercord presentation, March 8th 2015, (SICPA OTP Presentation), pg. 14, 15 & 18, <http://www.mass.gov/dor/docs/dor/taxprofessionals/illegal-tobacco-task-force/03-08-16-tobacco-taskforce-presentation.pdf>

³ Since the implementation of the encrypted SICPATRACE™ tax stamp in 2010, Massachusetts experienced no gain in volume of tax-paid cigarettes, but rather a decline, Tax Burden on Tobacco, Volume 49, 2014, pg. 335
http://www.taxadmin.org/assets/docs/Tobacco/papers/tax_burden_2014.pdf

off-the-shelf-solution”. Those that have looked at this in the past, including Massachusetts, have come to a different result.⁴

Currently, there is no state in which stamping agents, using an automated process, apply state excise stamps on cans of MST or any other form of OTP. Additionally, there is a significant likelihood that any tax stamping proposals that include the potential destruction of the MST packaging, as proposed by SICPA, would raise significant legal issues. Lastly, MST stamping is part of the much larger issue of MST revenue enforcement and a clear strategy for how to protect MST excise revenue is critical to the assessment of any additional tools. When the Massachusetts Commission on Illegal Tobacco studied this issue with that context it recognized that there are more cost effective tools available to address MST diversion than the stamps that SICPA proposes.⁵

SICPA’s Interest In MST Stamping

As the provider for cigarette tax stamps in 46 states, dozens of Native American Tribes and hundreds of localities,⁶ it is understandable that SICPA would pursue the potentially tremendous financial benefits that could be realized by persuading states to likewise purchase SICPA stamps for other taxable items, such as OTP. To date, however, all of the states that have considered OTP stamping, including Washington, Oregon, Minnesota and Massachusetts, have rejected it.

We agree with and believe the findings of the Massachusetts Commission on Illegal Tobacco (Commission) still hold true:

“[I]t remains questionable whether the technology to stamp other tobacco products is readily available at this time, and if that technology was available, it must be determined who would assume the costs of the expansion.”⁷

Automated MST Stamping Does Not Exist

MST is commonly sold in shrink-wrapped rolls of 5 or 10 cans. To stamp individual cans, the shrink-wrap would need to be cut open. After stamping, the shrink-wrap would need to be re-applied and resealed, if possible, or new shrink-wrap would need to be fitted. While machinery to affix self-adhesive stamps, which are essentially stickers, may exist, no machinery exists for this much more challenging process. Even SICPA admits it is not aware of any existing off-the-shelf slitting and re-shrink-wrapping solutions. Rather, they would need to be investigated,

⁴ Various OTP proposals have been rejected since 2009, including in Washington, Oregon, Minnesota and Massachusetts

⁵ “Report of Commission on Illegal Tobacco”, Commonwealth of Massachusetts, March 1st 2014, (Commission Report), <http://www.mass.gov/dor/docs/dor/taxprofessionals/illegal-tobacco-task-force/report-of-commission.pdf>

⁶ With the acquisition of Meyercord Revenue in 2010, SICPA overnight became the single provider of cigarette tax stamps in the United States.

⁷ Commission Report at pg. 8

adapted and integrated.⁸ In the meantime, given the lack of existing machinery, labor intensive de- and re-sleeving by hand is the only option.

Destruction of MST Packing Raises Significant Legal Issues

Even more concerning, de-sleeving and re-sleeving rolls of MST creates significant federal compliance concerns and could violate federal law. Several federal laws, including The Comprehensive Smokeless Tobacco Health Education Act of 1986 (Pub. L. 99-252), and The Family Smoking Prevention and Tobacco Control Act (Pub. L. 114-38) (collectively, the Acts) mandate strict packaging and labeling requirements, including warning requirements that specify verbiage, placement, readability, rotation, size and font of warnings on MST sold in the United States. Warning labels “shall be introduced by each tobacco product manufacturer, packager, importer, distributor, or retailer”.⁹ The warning requirements apply to MST sleeves, which are “packaging” under the Acts. Removal would result in destruction of packaging that complies with very strict requirements under federal law and no solution exists that SICPA reveals or of which we are aware to avoid noncompliance. Any de- and re-sleeving process developed must be executed in a manner that retains the required warnings and other elements such that they comply with all applicable federal requirements. Non-compliant packaging cannot be sold, thus elevating this practical obstacle to a legal one.

Even the automatic stamping machinery SICPA claims exists may not be adequate. SICPA’s presentation does not explain how the machinery would accommodate Massachusetts’ *ad valorem* tax structure for MST, which creates a variable tax rate based on the manufacturer’s list price. As a result, unlike cigarettes, MST tax stamps would need to accurately reflect potentially hundreds of tax amounts. Even if a solution can be developed, it undoubtedly would create significant complexity, potential for errors and a burden for wholesalers.

Costs Outweigh Benefits

There is no way to fully estimate the cost to develop and implement MST tax stamping at this time, because there is no system to implement. As indicated in SICPA’s “Go-To Market Roadmap”, new machinery must be designed, developed, prototyped, integrated, tested and piloted before released for use.¹⁰ By seeking Massachusetts’ adoption at this point, it appears SICPA intends to transfer some or all of the costs to develop a solution, from which SICPA is likely to profit significantly, to Massachusetts’ wholesalers or the Commonwealth itself.¹¹

⁸ SICPA OTP Presentation at pg. 21

⁹ 15 U.S. Code § 4402 - Smokeless tobacco warning

¹⁰ SICPA OTP Presentation at pg. 20

¹¹ The Commonwealth will likely have to pay for new machines associated with OTP stamping, just like Massachusetts and Michigan ended up reimbursing wholesalers for new tax stamp machines required for encrypted cigarette tax stamps.

Once developed, it will cost at least \$3.6MM to install just one new stamping machine per licensed wholesaler,¹² not the multiple machines (for de-/re-sleeving and multiple OTP products) proposed by SICPA. Finally, the Commonwealth also would have to purchase SICPA's self-adhesive SICPATRACE™ stamps, which sell for between \$5 - 8 per thousand stamps. This cost could increase further to accommodate the *ad valorem* tax structure.

Although not mentioned by SICPA, any cost calculation must also include additional costs for enforcement. Tax stamps alone do not stem illicit trade or significantly increase tax collection. The significant and growing amount of smuggled cigarettes between Virginia and New York, as detailed in our 2013 submission, is a vivid example how tax stamps alone provide very limited impact, if any, on illegally smuggled product. Both New York State and New York City require tax stamps on cigarettes, yet The New York City Department of Tax and Finance ("NYDTF"), estimates that "[h]alf the cigarettes sold in New York City are sold with fake tax stamps or no (New York) tax stamps at all."¹³ This is despite the efforts of a state-wide task force dedicated to tobacco enforcement and efforts of New York City officials, which, as noted in the Commission's Report, have had measurable successes in averting the loss of cigarette tax revenue.¹⁴ Increased enforcement in Massachusetts – and its costs – must be factored in and weighed in considering whether a proposed tax stamp solution's costs are worth its benefits.

SICPA indicates that Massachusetts can quadruple its MST excise tax revenue collection by adopting SICPA's tax stamping solution.¹⁵ SICPA's revenue projections are unreasonably derived and high. They are based on an equation that pieces together data from several unrelated studies with differing timeframes and applies illogical assumptions and over-simplified generalizations about MST use in Massachusetts. For example, SICPA assumes that "*yearly consumption [of MST] per person is homogenous among the various states*".¹⁶ However, Public Health studies have consistently shown smokeless tobacco use in Massachusetts to be among the lowest in the nation.¹⁷

If SICPA's math were correct, tax collection annually for MST and OTP should be \$80.5MM and \$154.2MM respectively. This would make the Commonwealth the second largest OTP tax collector in the United States after Texas (and more than New York, Florida, and California¹⁷) even though the Commonwealth is 14th in population. In fact, OTP tax revenue accounts for only 4.8% or \$31.1MM of all tobacco taxes collected in the Commonwealth. MST tax revenue accounts for about half, or only \$16.1MM (2.5%), of the total.¹⁸ The current revenue and more

¹² Once designed, machines are likely to be more or as expensive as cigarette tax stamping machines, which cost up to \$150,000 apiece. The Commission on Illegal Tobacco in 2014 reported 24 DOR licensed stampers / wholesalers, Commission Report at pg. 16

¹³ Meredith Hoffman, "Half of Cigarettes Sold in City are Bootleg, DA Says," DNAinfo New York, February 29, 2012, <http://www.dnainfo.com/new-york/20120229/williamsburg-greenpoint-bushwick/bootleggers-steal-taxes-on-half-of-cigarettes-sold-city-da-says>

¹⁴ Commission Report at pg. 5

¹⁵ SICPA OTP Presentation at pg. 14-15 (emphasis added).

¹⁶ Smokeless Tobacco Use in the United States, CDC, http://www.cdc.gov/tobacco/data_statistics/fact_sheets/smokeless/use_us/index.htm

¹⁷ U.S. Census, www.census.gov; Tax Burden on, Volume 49, 2014, http://www.taxadmin.org/assets/docs/Tobacco/papers/tax_burden_2014.pdf

¹⁸ *id* Tax Burden on Tobacco, Volume 49, 2014, pg. 107

realistic OTP tax revenue increases do not justify the unspecified but undoubtedly multiple millions of dollars in costs required to develop and implement an OTP tax stamp system.

More cost-effective and readily available means to address MST tax evasion exist, like those studied and recommended by the Commission. We urge the Task Force to continue its path toward implementing those recommendations and respectfully submit suggestions for a comprehensive anti-illicit trade approach in the Appendix to this letter.

As a long-time participant in addressing the illicit trade in tobacco products in the United States, we remain committed to working with the Commonwealth to find meaningful solutions to OTP issues. We appreciate the opportunity to share information and provide our perspective, and we look forward to further opportunities to discuss these issues with the Task Force.

Sincerely,

A handwritten signature in cursive script that reads "Michael Thorne-Begland". The signature is fluid and elegant, with a long, sweeping underline that extends to the right.

Michael J. Thorne-Begland

APPENDIX

Framework for developing better data and increasing OTP and MST tax compliance

Like the Commission, we believe a comprehensive approach to fighting illicit trade. With the establishment of the Illicit Tobacco Taskforce, the Commonwealth set the foundation by implementing recommendation 1 and 3 of the Commission's report.

The Illicit Tobacco Taskforce has the opportunity to continue this momentum by implementing the remaining recommendations to increase the availability, transparency and usage of data from the legitimate distribution channel to prevent illegal tobacco sales.¹⁹

This increased data and tax compliance can be achieved by (1) augmenting data availability through increased record keeping and reporting requirements, (2) increasing licensing requirements and transparency, (3) requiring purchases to be only between licensed entities, (4) banning cash transaction, (5) increasing seizure authority, and (6) increasing fines and penalties for violations. (7) Finally, implement provisions require technology providers to carry the full development costs of newly proposed technologies

- 1) **Requiring purchases to be only between licensed entities:** Require transaction to be only between licensed parties and require a full record of transactions to be kept on location for immediate inspection. Wholesalers need to show records for all products purchased and sold. Retailers need to be able to provide invoices for all OTP in store. Virginia enacted various laws, which prohibit the possession of more than 25 cartons of cigarettes by anybody outside of the legitimate distribution chain. Ohio has stringent requirements on documentation and invoices to be kept on premise for inspections.
- 2) **Augment data availability:** Examine what data is already available and what additional data can be made available through increased record keeping and reporting requirements. SICPA's "Invoice Data Capture Interface" appears to provide an attractive technology solution to increase the availability, transparency and usage of data for enforcement efforts without significant technology, machinery or infrastructure investments.
- 3) **Increase licensing requirements and transparency:** Establish a separate OTP license for every participant in the distribution chain. Strengthen licensing requirements through improve background checks and require regular license renewals. Publish all licenses to make it easy to identify legitimate participants in the distribution chain. Florida and California have stringent licensing requirements and publish tobacco licenses. California in particular has a very robust online portal to search for and verify licenses.²⁰

¹⁹ Commission Report at pg. 5 – 7

²⁰ <https://efile.boe.ca.gov/boewebservices/verification.jsp?action=SALES>

- 4) **Ban cash transactions:** Law enforcement reports that illicit tobacco transactions rely heavily or almost exclusively on cash transactions. This increases the transparency of transactions. The Massachusetts Illegal Tobacco Commission Report was the first report to recommend this opportunity.
- 5) **Increase seizure, forfeiture and churning authority:** Classify OTP product without documentation and invoices as contraband. Expand seizure authorities for DOR and other enforcement authorities to immediately seize all OTP classified as contraband. As a result, the DOR can seize all OTP products for which the retailer cannot produce documentation. Increasing seizure and churning authorities would allow tobacco enforcement law enforcement to further investigations and enforcement. The State of Ohio has provides such seizure rights to its tobacco enforcement personnel.

In addition, the Commonwealth should publish seizure notices and results online. The State of Florida publishes their seizure results regularly.

- 6) **Increase fines and penalties for violations:** Increase civil and criminal fines and penalties and lower penalty thresholds. This should include license revocation of all state licenses for violation of the tobacco tax laws, such as loss of Liquor, Lotto, Gas and Business licenses for violation of tobacco tax laws. For example, the states of New Jersey, New York and Maryland have all passed laws to increase the fines and penalties associated with tobacco trafficking. For example, New York State now imposes a penalty of up to \$600 per carton on each seized carton of illicit cigarettes, while Maryland now has a minimum fine of \$150 per seized carton of illicit cigarettes.
- 7) **Require technology providers to carry the full development costs of newly proposed technologies:** Should the state agree to cover development costs, implement “claw-back” provisions for missed tax revenue projections and incorporate revenue sharing provisions for commercialization of new technology across multiple states. States should not have to shoulder the development costs for new technology without protection or the potential for revenue share. Technology providers will likely profit significantly from successful implementation of new technology. Alternatively, the state could ask for exclusive rights, intellectual property rights or royalty agreements in exchange for development costs.